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## STATE AND NATIONAL EXAMINATIONS OF BANKS

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Much unjust criticism has been made by bankers and bank examiners against each other, and the general public has frequently condemned both. When a trusted bank officer or clerk decamps with the bank's money the popular cry is heard to the effect that all bank men should be watched closer; and there is also heard the oft repeated demand, "Where was the bank examiner?" In the mutual effort to serve the public well and faithfully, cordial co-operation and perfect understanding between the banker and examiner should take the place of suspicion and distrust. Criticism is unjust when entertained before due consideration of all of the facts has been given.

As an examiner, I ought to believe that every bank officer and clerk is absolutely honest and conscientious, and my investigations should be directed to the proving of my theory; and as a bank officer, director or clerk, I ought to feel that the examinations have been instituted and conducted for my benefit as well as for those who have placed their trust in me. It frequently happens that unnecessary friction is allowed to creep in and destroy the best results that might otherwise be derived from the visits of the examiner. Constant contact with the many phases of the banking business in many banks enables the thoughtful examiner to see some of the relations between facts and uncertainties in a clearer light than is possible for some strictly local bank officers; and the friendly discussion with the examiner of such matters as arise in the course of his business would be of greater benefit to the banker than he could realize until he has experienced it. On the other hand, the trained banker can, if he will, impart to the examiner a knowledge of specific acts and circumstances surrounding specific transactions, to be learned in no other way.

The best examination results from the joint efforts of the banker and examiner working together, each possessing good judgment and tact, and each having an earnest desire that the bank

be searched through for an untoward act or transaction that ought to be uprooted before it has fastened its ugly tentacles. A bank official expressed the idea of value to be obtained from contact with the examiner in the following language:

We bank officers are so close to the scene of action, that we do not look upon it in the same way as an outsider and the opinion of another is often refreshing and helpful.

In the consideration of the subject of an examination of state and national banks, we should keep in mind the immense task imposed upon those responsible for such labors. The Monetary Commission reports that in April, 1909, there were 22,491 banks of all classes doing business in the United States. These banks handle assets amounting to the vast aggregate of \$19,583,410,393, which in total and in detail must be accounted for, and, with few exceptions, examined one or more times each year by the state or national examiners. The number of examinations required by the laws of the states varies from one examination to five annually. The national bank examiners visit the bank as nearly twice each year as possible.

The examiner has to contend with a great many difficulties not ordinarily known to the public. One of the obstacles consists in the attitude of the directors and officers when violations of the law are called to their attention. This, of course, is more particularly true in some country banks, where the directors have had very little general experience outside of the small trades or occupations in which they are engaged, many of them being farmers.

#### *Requirements of the States*

With but few exceptions all of the states have provisions for examinations of banks, although some of the laws regulating the control of banking have been but recently enacted. In Arkansas, the state auditor says, there are no banking laws and no examinations of banks, and so late as 1909 the Superintendent of Banking in Ohio states that none of the banks of the state had ever been examined before.

From Arkansas, where no examinations of any kind are required, it is a long cry to Rhode Island, where provision is made not only for two examinations annually by the bank commission,

but in addition private examinations are required by law. So far as I have been able to learn, no state in our union has gone the lengths of Rhode Island in directing how examinations, other than official, shall be made. A letter dated June 10, 1910, addressed to the banks, signed by the bank commissioner, calls attention in the following language to the law recently passed: "Heretofore the law laid this duty directly upon a committee of the trustees, but now this duty must be performed by a certified public accountant of this state, whose examinations and reports must cover subjects and be in a form satisfactory to the bank commissioner." At the end of the letter are given the names and addresses of the certified public accountants of Rhode Island.

Between these two extremes the other state banking departments are operating under laws of varying force and scope.

#### *National Banking Supervision*

The Comptroller of the Currency is the superintendent of the national banks. In his last report dated December 6, 1909, he states that on September 1, 1909, there were 6,977 national banks in operation grouped as to capital into the following divisions:

Capital	Number
\$25,000 .....	1,815
Over 25,000 less than \$50,000 .....	384
Over 50,000 less than 100,000 .....	2,217
Over 100,000 less than 250,000 .....	1,909
Over 250,000 less than 1,000,000 .....	492
Over 1,000,000 less than 5,000,000 .....	149
5,000,000 and over .....	11
Total .....	6,977

The national act from which the Comptroller of the Currency derives his power was originally passed as a currency measure. The government desired to place the issue of bank currency in banks operating under a national charter and at the same time provide a means for marketing its bonds. The original scope of the examiner's duties seems to have limited the examinations somewhat to such inspection as would assure the comptroller that the notes issued by the bank would be paid upon presentation at the bank, and thus prevent the necessity of sale of the bonds deposited in Washington as collateral security for the notes. A few hours'

work in each bank seemed to be all that was considered necessary for such purposes as were originally in contemplation; and the fee was, in 1862, deemed ample compensation. In some cases more than one bank examination could be completed in a day's work; thus a comfortable income resulted to the examiner. The act of Congress governing the scope of the duties of the examiners has not been changed in this respect from that day to this, but the rulings of the several comptrollers have gradually increased the labor of the examiners to such an extent that with few exceptions they are to-day very poorly paid for the amount of work they are required to do.

Part of the enlargement in the scope of the examination is attributable to the accumulation of experience which each successive comptroller has found at hand, partly to recommendations of bank officers; but the bulk of the work now done by the national bank examiner may fairly be attributed to the zeal on the part of all officials inspired by the pressure of public opinion. Each embezzlement of bank funds by officers or clerks and each failure of national banks has created in the minds of the general public a feeling that greater efficiency in the comptroller's office would have prevented the loss. Thus, the comptrollers stimulated to increased endeavor, have added from time to time things necessary for the examiner to do to safeguard the funds of the depositors, until, at present, instead of a cursory inspection of the available assets of a bank for the purpose of determining that the national bank currency would be honored, the examiner must go into, and report upon, a multitude of details, originally scarcely contemplated as necessary or desirable.

The most recently reported order of the comptroller will illustrate as well as any other the difference in the present and former requirements. The examiners will now be required to exercise judgment as to whether a weak bank should be allowed to continue in business; and for the purpose of coming to some conclusion in the matter without waiting to file their reports, they should call the directors to a meeting to consider the financial condition of the bank with a view of liquidation. Think of it! A man who may possibly receive the mere pittance of \$20.00 for an examination of a bank must be of such caliber that dependence may be placed upon his judgment as to whether that bank should be closed up or

nursed along. This disproportion between brains required and the compensation allowed should be adjusted without delay.

While there is some adverse criticism of the present Comptroller of the Currency in his exacting demands upon the directors and officers of the national banks for a better performance of their duties, it seems to be pretty generally conceded that such steps are well considered; that the comptroller should enforce the law as he finds it, and that this will result in great improvements in the national banking business. If the law is unjust in any way, the quickest means by which it can be changed is for him to enforce it. That many of the points on which he insists are considered good is shown in the reports of many state bank commissioners. His example is being followed by numerous state officials, while others express the regret that they have not the power to adopt some of the requirements of his office.

One of the greatest difficulties confronting all banking departments is the tendency on the part of banks to loan money to their customers in excess of the amount declared by law to be the limit to which loans can be made. The comptroller states that, in spite of his watchfulness, caution, and remonstrances, over fifteen per cent of the total number of banks doing business report excessive loans.

The amount that can be loaned to any individual, firm, or corporation is an amount equal to ten per cent of the bank's capital and surplus, providing that the total of such loan does not exceed an amount equal to thirty per cent of the capital stock of the bank. The penalty for violation of this law is so severe that it has rarely been imposed, and many banks openly violate the law on the ground that it is unjust and that it interferes with their business. A bank with a capital and surplus of \$1,000,000 could accommodate a wealthy and desirable customer with only \$100,000 if the law were strictly obeyed, yet the bank might have many millions of deposits available for loans. For the bank to make a larger loan, there must be an increase in capital or a change in the law. That the banks do not consider the law one to be obeyed to the letter is shown in the fact that over one thousand banks voluntarily reported excessive loans in September, 1909.

A new feature adopted by the present comptroller consists in the organization of the examiners in the field. There are now

between 95 and 100 national bank examiners who have been grouped or classified into eleven or twelve territorial districts by the comptroller. It is intended that these groups of examiners shall meet twice a year for the exchange of information regarding borrowers in their district, and a discussion of any suggested improvements in the examinations that may be made under existing conditions.

Each group is presided over by a chairman, who assigns to each examiner the task of writing a paper to be read at the meeting. The chairman himself also writes a paper, and the meetings are intended to be of great use to the examiners in tending to perfect them in their work. This organization of examiners into these associations, if properly handled and maintained, will bring about much, although in the hands of immature men there is grave danger of indiscreet treatment of the confidential knowledge entrusted to them. This must be carefully guarded against.

#### *Qualifications Required of Examiners by State and National Authorities*

Unfortunately, at least in the past, political influence more than ability has assisted candidates to obtain the position of examiner. Perhaps the following is an extreme illustration: A newly appointed examiner was sent to an old and experienced examiner for training. In a conversation with the appointee, it was learned that he knew nothing about the business, possessed no experience whatever in banking and had, in fact, neither applied for, nor desired, the position of examiner. He was, however, a supporter of certain political influences in his state and was filled with a laudable desire to become a United States marshal or assistant United States district attorney. His benefactors did not happen to have just such a job handy so they asked the comptroller to appoint him bank examiner. He frankly told the comptroller, he said, that he knew nothing about a bank. The comptroller, it is said, told him that he could learn and he was thereupon sent to the old examiner for instructions. Extremes meet among the examiners, as well as in other classes. Some examiners have served years of useful employment in a bank, after which they have been taken to Washington, where they were thoroughly drilled in the analysis of reports of examina-

tions. After all this training, they were allowed to go out in the field.

It is very fortunate indeed that the comptrollers have to a large extent disregarded political pressure and that very few examiners have been removed because of their politics; the examiners appointed purely for political reasons are being carefully weeded out, and to-day it may be said that the examiners are as a class equal, if not superior, to any other body in the national or state service.

In some states the examiners are required to have had certain qualifications, including a definite number of years of active bank experience, while in other states the matter is left to the discretion of the bank commissioners. In Texas, for example, every examiner must have been an "expert bookkeeper and bank accountant" and must have had practical experience in the banking business for at least five years. This expert receives a salary of \$2,000 per annum and must furnish a bond of \$10,000. In West Virginia the candidate must be "skilled in the science of bookkeeping and banking" and must have had at least "two years" experience as cashier or assistant cashier in a bank, or shall have served at least two years as assistant commissioner of banking, banking examiner, or as an accounting officer of the state."

A curious condition was discovered in Georgia by the state treasurer, who in that state is also bank examiner. In his report for the year 1909 he says:

In this department I found that bank examiners were in business for their health and each had resigned positions to accept service in the department because it afforded them outdoor work, although at a less salary. Up to the present time the salaries range from \$1,200 to \$2,000 per annum, the same being paid out of fees received from the banks examined, and, be it said to the credit of the banks throughout the state, that they are willing to pay a larger fee for a more thorough examination such as will keep in the service accountants of ability at salaries commensurate with the service rendered.

In discussing the qualifications of the bank examiner the commissioner of Kansas in his report for the year 1908 says:

In short, judgment is the best asset of a bank examiner and the person who has found judgment supplemented with experience as an examiner is the one whose services become invaluable to the state, and such a bank examiner should be retained regardless of political affiliation.

In an address by Hon. H. M. Zimmerman before the Michigan State Bankers' Association in 1907, he took occasion to observe:

The experience of the department shows that it takes years to make a thoroughly competent examiner even when his previous experience has been along the line of bank work, and each succeeding year's work in the service adds greatly to his efficiency.

It is the belief of the superintendent of the banking department of Ohio that

The work of the department should be so quietly done as to be unnoticed, and that the better its work, the less will be heard from it.

The commissioner of the State of Idaho well describes a certain phase of the work of an examiner in the following language:

The duties of an examiner are of such a nature as to require men of ability and fitness. Because the duties of an examiner are of a confidential nature and he cannot submit himself to newspapers' interviews, the general public knows very little of his work unless there is a failure in his state, the whole community is then ready to tell how the examiner was incompetent and that the bank should have been closed long before. They do not know of the many special reports and efforts that have been put forth to save the institution, nor do they ever hear of the numerous banks that are saved in this way from failure.

The state examiner of the State of Washington says that

The state banking department here is conducted along as rigid rules as we know how at the present time, and that we regard our examiners in the same class as the national examiners of this state, and that the examiners here are equal to the best. We are working in perfect harmony with the national department so that all information gained by one department of interest to the other is exchanged.

#### *Compensation of Examiners*

The state examiners as a rule receive salaries in addition to their actual traveling expenses, while the national bank examiners receive a graded fee for the examination of each bank, out of which they must pay for such assistants as they require and also all traveling and other expenses.

The salaries of the state bank examiners, with few exceptions, range from \$1,200 to \$4,800 per annum, many of them working hard all the year, and nearly every day in the year, for the small annual sum of \$2,000.

The total amount collected from national banks and paid to the examiners for the last year was \$510,928.07, or an average of about \$5,000 to each, but by far the larger number receive less than this average. The Deputy Comptroller submitted to the Monetary Commission the following table of amounts paid:

**GROSS INCOME OF NATIONAL BANK EXAMINERS.**

14	receive over	\$2,000	but less than	\$3,000
18	receive over	3,000	but less than	4,000
30	receive over	4,000	but less than	5,000
13	receive over	5,000	but less than	6,000
6	receive over	6,000	but less than	7,000
2	receive over	7,000	but less than	8,000
2	receive over	8,000	but less than	9,000

The New York and Chicago examiners not included in this table receive between \$18,000 and \$19,000 each. Out of their gross income all examiners must pay their own traveling expenses, assistants and other expenses, amounting to about one-third of the total compensation, so that the net income in most cases is very small in proportion to the responsibility assumed.

*Character of Examiners*

Fully appreciating the honesty and strength of character possessed by bank officers and clerks as a class, it is to be most deeply regretted that exceptions to the general rule exist among them. While the thoroughly efficient examiner preserves an attitude of belief in the honesty of all the bank men met during the performance of his duties, he must be ever alert to detect the acts of the unfortunate and misguided man who has fallen a prey to temptation. Such men are constantly studying ways and means of covering their embezzlement, becoming in some instances experts in concealing traces of their guilt.

An examiner can spend usually not more than a few days each in the examination of a large bank and rarely more than one day each in the banks in smaller cities and towns. Much routine work must be done in this short time to cover the requirements of the state or national regulations, and some examiners unwisely yield to the impulse to fall into ruts of clerical performances not conducive to unearthing well-covered stealings.

The bank man whose accounts are crooked watches the exam-  
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iner closely, studying every move, that he may know wherein the least danger of discovery lies. He knows exactly where the needle in the haystack is, while the examiner does not even know that there is a needle in the haystack at all. If the examiner paws over the surface of the stack with regular motions at each visit, the guilty possessor of the secret knows where the needle may be buried with least danger of discovery.

The examiner must keep in mind that, while by far the greatest majority of bank men are thoroughly honest in word and act, there may be some men among them guilty of as yet undiscovered fraud. The examiner should study the general subject of fraud in banking thoroughly. One bank cashier says that his experience shows that "*the most usual causes (of fraud) are the following: First, one-man banking; second, corrupt politics; third, excessive loans to directors.*"

The examiners who understand their duties and perform them faithfully are well respected by the bank officers. A vice-president of a large national banks says:

In a banking experience of forty odd years in a New York City national bank I have been present at every examination except three made by national bank examiners and committees from the board of directors. I think I know all the tricks and possibilities of the business and for the life of me I could not improve on the examinations I have witnessed.

Some examiners go more deeply into the affairs of the bank than others, but none of them pretend that their examinations are as thorough and searching as they would be if the conditions under which such examinations are made were different, and they were afforded more time and assistance. The present comptroller is making earnest efforts to improve the efficiency of his staff of examiners; and, so far as can be learned from the reports of the various state banking commissioners seen, they all realize the need for improvement and are striving to purge the service of weak examiners and at the same time increase the ability of the good man.

The success of an examination depends so much upon the good judgment of the examiner that it is absolutely impossible for the state or national authorities to formulate rules for the conduct of an examination to the extent that mere following of the rules will produce good work. Each good examiner works along his own line of investigation in digging under the surface of things as they

appear, while following a general plan laid down by his superiors framed to verify so far as possible in a short time the existence of the assets and liabilities of the bank as shown by its books.

While some of the bank examiners are men of training and good judgment, and are persistently faithful in their work, others have fallen into a routine performance of their duties calculated to enable them to finish an examination and make a complete report to their superiors in what they think is a reasonable time. It is to be regretted that such work results in a superficial view of things too often expressed in stereotyped language in the reports. As one experienced state banker expresses it, "The principal weakness in the present system of state bank examination appears to me to be a lack of thoroughness and a disposition to only examine surface conditions." He goes on to say that he thinks this "is caused not by the incompetency or unwillingness of the examiners themselves, but by the fact that they have so many institutions to examine that it is really impossible for them to furnish anything but a tentative examination."

Much thought and inquiry outside of the actual work in the bank is undertaken by all good examiners. As an example of the industry and effort on the part of some examiners and the extent to which their labors lead them, the Philadelphia National Bank Examiner, an able man, has taken a step in the obtaining of information which places at his disposal very valuable data. He has inaugurated a credit ledger in his office which contains the names of about 800 of the larger mercantile and manufacturing concerns in the Philadelphia district. It is intended that a letter will be mailed each month to all of the banks in his district, requesting them to furnish the amount of the loans to each and all of the 800 concerns on a given day. This information is to be written in his credit ledger and he can at any time turn to this ledger and ascertain the borrowing of any one concern in all the banks in the district, and any bank in his district can obtain the information by inquiry of the examiner. In a very comprehensive way, he has thus started what may eventually become extended into a very comprehensive credit bureau.

*Improvements in Existing Laws Suggested*

There is hardly a bank commissioner in any of the states who does not in his reports recommend changes in the laws governing the business of banking and its supervision by the state authorities. There is a general tendency in the state legislatures to adopt the suggestions of the commissioners to the effect that restrictions may be placed on certain banking practices, particularly upon the limit of the loans. In Idaho, for example, it is proposed to pass an act reducing the amount that may be loaned to any corporation or person from fifty per cent to twenty-five per cent. The state bank examiner of South Carolina recommends that he be given authority to direct the charging off of worthless paper stating that

There are a number of banks perfectly sound and solvent, that are carrying varying amounts of worthless paper, publishing same as good, live assets. They have ample profits to take care of these worthless notes and should be compelled to do so and discontinue the making of misleading reports to the public.

The various comptrollers of the currency, the national supervisors, have suggested improvements in the national bank acts. Perhaps one of the most interesting documents relating to examinations is one published this year, No. 404 of the National Monetary Commission, containing "Suggested Changes in the Administration Features of the National Banking Laws." Recommendations are made by national bank examiners, clearing house associations and state banking officials throughout the United States. There are also the statements made at the hearings of the commission by the Secretary of the Treasury, Comptroller and Deputy Comptroller of the Currency, and the presidents of several national banks. Many different views are expressed in these suggestions regarding certain features of the laws pertaining to the examinations of national banks.

The following is a list of some of the questions propounded by the commission together with a summary of what appears to be the preponderance of opinion in the answers to each:

1. Section 5240 of the Revised Statutes authorizes the Comptroller of the Currency, with the approval of the Secretary of the Treasury, to appoint suitable persons to make examinations of national bank associations.

Should, in your judgment, the method of appointing examiners be continued as at present or be made subject to civil service rules?

Is it desirable to apply civil service regulations to the tenure in office of bank examiners?

Examiners should be appointed by the comptroller without regard to politics, but with regard to special fitness, the comptroller to take the advantages of the civil service examination if it would be of assistance in selecting a candidate. The examiner should be kept in service during faithful performance of his duty, but should be removable by the comptroller.

2. The same section of the Revised Statutes, 5240, provides the method for paying examiners, basing it on the fee system.

In your judgment is it desirable to change this to a salary or per diem basis, to which there should be added the necessary expenses incurred in making examinations, it being understood that banks shall be assessed to pay salaries and expenses in a similar manner as now provided for by the existing law?

The examiners should be placed on a graded salary basis with allowance for actual expenses. The fee system tends to produce superficial work, creates routine performance and, in an effort to save expense, the country bank examiner pursues the same route and can easily be traced by banks in the localities in which he is working; thus banks are able to calculate about when the examiner will arrive.

3. In making assessments to provide a fund to pay examiners and other expenses, do you think the law should be changed so as to base the amount of this assessment on capital and gross assets rather than on capital alone, as the law now provides?

Fees for examination should be based upon gross assets as the fairest method of indicating the amount of labor performed.

4. Do you think it would be desirable to provide a force of assistant examiners to work in co-operation with examiners in large places, and, in future, when vacancies occur, to recruit the force of examiners from these assistants?

This would be a wise provision in order to train examiners, but the comptroller should not be required to select solely from this class in filling vacancies in the position of examiner.

5. As examiners are frequently in charge of failed banks, acting as temporary receivers, do you think it would be desirable to require them to give

a sufficient bond for the protection of the government and the bank when such contingencies occur?

Few seem to think that bonding of examiners is necessary, but most were inclined to agree to the proposition, if desired by the comptroller for any reason.

11. Under Section 5211 of the Revised Statutes, which provides for bank reports, banks are not required to make them in duplicate, and in several instances the examiner has been furnished by the officers of the bank with a report entirely dissimilar from the one on file at the department in Washington, and, in using the imperfect report, he has found that the bank's books correspond to it. This permits of deliberate falsification of accounts.

Would it, in your judgment, be wise to require that reports be made in duplicate, both reports being sent to the Comptroller of the Currency, and one copy furnished to the examiner by the comptroller when about to undertake the examination of the bank?

While some views were expressed dissenting from the thought that the banks be required to issue duplicate reports for the convenience of the examiner, most of them seem to acquiesce in the evident desire on the part of the comptroller that duplicate reports should be sent to him, one of which could be used for the purpose of examination by the examiner.

14. Section 5209 of the Revised Statutes makes it a misdemeanor for an officer or an employee of a bank to make false entries with intention to deceive, but the courts have decided that this does not apply to reports made to the Comptroller of the Currency, as he is not mentioned in the law.

Should not the law be extended to apply to false reports made to the comptroller?

There seemed no doubt whatever that the false entries made in reports to the comptroller should be subject to the same penalty as though made to deceive any other person.

19. Have you any suggestions to make relative to changes in the organization of the comptroller's office? There are many other minor changes which it is apparent should be made in the administrative features of national bank laws, some of which may occur to you, and the commission will be gratified if you, in answer to the above questions, will make any recommendations which seem to you wise, giving your reasons for urging such changes.

There did not seem to be any dissenting voice against the placing of more power in the hands of the comptroller in the enforcement

of the national bank act by penalties not now provided. Under this heading some suggestions are offered regarding the appointment of a supervisor and commissioner in different districts to supervise the work of the examiners. Some recommended the changing of the examiners frequently, and others opposed the view on the ground that an examiner can do better work in banks where he handles the assets several times per annum.

#### *Suggestions for Improving Official Examinations Under Present Conditions*

The able examiners are not waiting for changes in the laws to give them more opportunities for better work. The good men are making the most of conditions as they find them. Anything short of unstinted praise in appreciation of the good work such examiners are doing would argue ignorance on the part of the critic. The points brought out in the following paragraphs are not intended as indicative of any shortcomings on those who are doing the best they can under the very trying circumstances in which all examiners are placed. The discussion is intended, first, to state a few of the defects existing in some banks, the presence of which the banks themselves ought to guard against; and, second, to make some kindly suggestions to the less experienced examiners who may desire to improve their efficiency.

There are very few cash items that have any proper place in the settlement of the cash at the end of the day. Too often, however, the "Cash Item" list is used for careless and slovenly banking. At the settlement hour, every check, note or draft should have been disposed of in the regular routine of the business. It sometimes happens that a check will come into the bank too late to put through the day's work. Such an item constitutes a permissible "hold over," but these items should be closely watched and it should be insisted that the amount be reduced to the absolute minimum.

While speaking of cash items, I am reminded of another fruitful source of temptation to the teller in some banks where protested notes and checks are allowed to remain in the control of the tellers. In one case a bundle of such was discovered, some of the protested checks bearing dates for days, months and even years prior to the date of examination.

The examiner frequently meets with a settlement of cash to a penny and is apt to consider the teller very accurate in his work. Sometimes the teller will say that he has "settled" for over a year. The wary examiner will look around for an "over and short" box before giving the teller full credit for what may be justly his due.

Unless examiners have been experienced tellers prior to their appointment the actual work of counting the currency and coin will be necessarily slow. The embarrassment created by the awkward handling of the cash by the examiner in the presence of the skilled teller operates sometimes to prevent a thorough proof of the cash, especially when the hour is getting late and the tellers and clerks are gathered around the examiner watching him with scarcely concealed contempt and sometimes audible sarcasm. Quick handling of the cash comes only after years of practice, and constitutes the chief difficulty that a bank examiner, otherwise brilliant, has to overcome.

Occasionally large loans in the form of checks are carried as cash items. As a rule such loans are intended to remain in the bank over night only, they being taken up or put in some other form the next day. Sometimes they are carried indefinitely, a new check being made out to take the place of an old one when the bank examiner comes around. This is one of the most easily misunderstood things that an examiner has to examine, and he may be of help in keeping the cash clear of such items by explaining to the directors and officers the undesirable features of the bad practice.

Dishonest cashiers and tellers sometimes carry their own borrowings as cash items, until the examiner comes around, when the amount of such items is charged up to various depositors' accounts, until the examiner leaves. The amounts then are either left as fraudulent charges in the depositors' accounts, or returned to the cash items. This can be easily accomplished unless the examiner is alert to locate the cash items at once on beginning his examination. He should very carefully scrutinize all the entries in the check and deposit "scratchers" for at least several days back and endeavor to verify the correctness of the charges and credits by comparison of the entries with the checks paid and deposit slips.

In examining the deposit ledger, he should keep in mind the possibility of entries in the accounts placed there temporarily to

straighten out the cash items or other shortage. In one case, an examiner in taking off a trial balance of the deposit ledger noticed an overdraft of \$1,700 apparently made good by a deposit several days prior to the date of his examination. He called for the deposit slip, but it could not be found; and the examiner, after a little more inspection, confronted the cashier with his suspicion that the credit entry was a false one and had been made in the account since the beginning of the examination. While the examiner was in the bank, the cashier had slipped out and exchanged his \$2,000 promissory note for that of a friend, which note he placed to the credit of the depositor whose account showed a false overdraft.

Holding back credits for remittances and deposits is a method adopted by some erring bank tellers to cover peculations. Special care on the part of the examiner should be exercised to prevent such practices because when once started, the risk of detection by the ordinary examiner is very small. He will, if careful, watch deposits being made until he has settled the cash and try to keep track of them to the extent that while he is in the bank the entries for these credits will not be omitted from the proper books or records. Otherwise he may count cash, the amount of which has not been entered into the day's business, the cash being handed to him to cover a shortage.

In cities where there are clearing houses, the national banks will have at the end of each day large amounts of checks received during the day to go to the clearing house the next morning. These are, so to speak, "legitimate" cash items, but they should be carefully scrutinized in order to detect false items.

Trust companies usually send all of the checks received by them during the course of the day to their depository, usually a nearby national bank. The pass book of the national bank showing the account with the trust company should, of course, be balanced at the close of the day on which the examination is made.

The general tendency among bank men to-day is toward the desire for ever increasing efficiency on the part of the examiner. With but few exceptions, they urge careful, conscientious work and recommend that nothing be taken by the examiners for granted. "All obscure or irregular matters should be verified or traced to their original sources," is a suggestion made by one of my friends. It expresses a thought that ought not to be lightly treated by an

examiner. Of course it is one that is carried out earnestly by the good examiners.

Another suggestion offered by the same friend is not usually thought of as feasible in the official examinations of state or national banks: "All assets," says he, "should be appraised by competent and expert appraisers and the attention of the management called to doubtful or unknown values." The examiner should endeavor to ascertain the value of every kind of asset, owned by the bank or held as collateral, and very little difficulty is presented in the readily marketable securities constantly quoted. While it may not be feasible at the present time for the national or state examiners to actually put values on all assets, it can be accomplished in the unofficial independent examinations by certified public accountants whose time limit for the examination can be arranged according to the necessities of the case.

One of the most important departments of a bank or trust company consists of its deposits. The verification of the accuracy of the books of the bank in this particular can only be accomplished upon a comparison of the bank's books with the depositors' pass books. It is usually so difficult to obtain the pass books during a short examination that this verification is rarely undertaken in the official examinations. This can be attended to by the clearing house examiner. I know of one at least, who deems the matter of great importance and who calls for a large percentage of all the pass books in each bank. Fears of a run on the bank by excited depositors has in the past operated to create great but natural stubbornness in bank officials against the attempt by examiners or accountants to get in pass books. In an experience including several sad cases of trouble the author has found that the bulk of the amount of the embezzlement was revealed when the depositors' pass books were examined.

One bank cashier states the matter very clearly in the following suggestion:

Examiners are particularly careful with the correspondent banks, why not with the individual? I have always thought it would be wise for an examiner—he is always with a bank several days—to send for such pass books as he may think advisable in scanning the ledgers and settle them while at the bank, having the balance checked up afterwards with the depositors in the same manner as he checks up with the banks. If the dishonest teller or bookkeeper knew this to be a general practice, he would

be very loath to manipulate figures, either in deposit slips or posting. The examiner may argue that he has not the time for exhaustive examinations, but the moral effect of even a slight effort in this direction, would, I think, be very beneficial.

The suggestion is put in another way by another bank cashier:

There appears to be abundant room for fraud by collusion between a teller and a bookkeeper in making false charges to cover shortages in cash. For this reason we can see that the accounts of the individual depositors ought to be verified by direct communication of the auditor or examiner with the depositor.

A trust company's treasurer goes a step further and recommends that the

Department should require its institutions to adopt a system whereby their pass books are settled periodically, a receipt containing a clause to the effect that the pass book has been received and verified, obtained from each depositor, or the settlement of pass books eliminated and a system of rendering accounts at stated periods adopted.

Here again is evidence of a dividing line between what the official examiner believes is the limit of his duties and what in his opinion ought to be attended to by the bank itself with or without the assistance of certified public accountants, who may, if employed, easily obtain the proper verification, providing the banks want a thorough examination and if the way in which the examination is carried out is tactful and persistent. Honest and entirely trustworthy bank men commend acts of precaution as evidences of that care upon which they in many cases rely as a safeguard against the embezzlement by their clerks.

One of my friends expressed himself very strongly on the subject. It is to be hoped that the suggestion applies only to some exceptionally careless examiner: "In all examinations and until the assets have been verified, the officers of the institution should have access to the assets only when accompanied by the examiner. This practice which is customary with certified accountants is neglected by the authorities of this state, and this oversight could easily be used by unscrupulous or dishonest officials to their own advantage."

Perhaps all of my readers know that the trust funds of a trust company are not included in its statement of final condition. If mentioned at all, the notation is usually made at the bottom of such

statement and is confined to the amount of trust funds invested and uninvested. The suggestion is that there should be:

An appreciation of the necessity of better examinations of the enormous assets and liabilities held by the trust companies in fiduciary capacities. This neglect has probably arisen from the fact that most of the older institutions to-day conduct this department of their business by single entry system of bookkeeping. Such make lapsed and complete audits almost impossible.

These trust assets and liabilities in many cases far exceed the total resources of the company and should be subject to careful and rigid verification.

The official examiner in some cases perhaps works too exclusively with the bank's own statement of its financial condition for his guide. There are many assets in a bank besides those appearing in the statement. Two of this character, the examination of which would operate as a safeguard against stealing, are expressed by the vice-president of a large city bank who recommends:

(1) The more careful auditing and verification of stocks, securities and valuable papers left with the bank for safekeeping; and

(2) Also a more thorough system of recording and verifying loans made on account of out-of-town correspondents. These are two weak points and should be carefully guarded by all of the banks handling this class of business.

From the official examiner's standpoint, such matters ought to be safeguarded by the banks themselves. He has his hands full in the verification of the assets and liabilities as shown by the bank's statement. If he can satisfy himself that the bank is in good condition and is not badly violating the law, he considers that he should not be required to try to find any other assets of the sort referred to. There is no doubt that the points raised by this bank official are highly important and they should be provided for in some way or another. The good examiner is fully aware of the possibility for manipulation in that kind of assets and he has not only the knowledge that the securities might be easily stolen by the dishonest clerk or official in charge of them, but he knows also of the opportunity for making these securities do the duty of taking the place of the bank's own missing securities and collateral.

That fictitious promissory notes have been prepared to deceive the examiners is a fact known to many examiners, and to bank men as well. One cashier has urged the importance of verification

of these notes in the following words: "All the discounted paper of the bank of any large amount (which is of course counted in the assets) should be known to be genuine."

The official examiner will say on this point that it is absolutely impossible for him to know the signatures of even the large borrowers in the banks. He can overcome part of the difficulty by calling in a committee of the directors of the bank to assist him in his scrutiny of the signatures, but in many instances the bank directors would not know as much about the signatures as the examiner himself, although a stranger to the borrowers. Perhaps the best way of verifying the genuineness of notes is by correspondence with the borrowers. The bank examiner has the right and power so to do, and some of them partially exercise that power. If a borrower admits directly to the examiner his liability, it is the best evidence that his note for the amount is at least genuine.

In large banks and trust companies a daily statement of the resources and liabilities is usually prepared each morning for the information of the officers and directors and is usually found in the possession of one of the officers of the bank or trust company, as the case may be. The treasurer of a large trust company makes a pertinent suggestion on this point:

I have noticed that the city and state examiners as well as C. P. A.'s all uniformly seem to ask the first thing on an examination for a copy of the daily sheet as it appears, each morning, on the president's desk. This copy may be made up by the general ledger bookkeeper, and I have never seen but one man compare it with the actual figures on the president's desk, which are of course made up by some one other than the general ledger bookkeeper. There seems to be a chance for the general ledger bookkeeper to make up a false copy of the president's sheet to agree with a falsified account of the general ledger.

A trust company treasurer with full knowledge of the handicapping conditions under which the examiner labors, says he believes that if the examiners

Were instructed to thoroughly examine one feature of an institution at each examination, choosing a different feature each time, that the present system would be much more efficacious. So many examinations merely consist of counting the cash, not very thoroughly, checking off securities, mortgages and other assets with the general balance sheet and taking a balance sheet from the individual ledgers. How much more effective it would be if a part of the time so spent were devoted to thorough analysis of the

institution's accounts with other institutions, or the verification of a large number of pass books or in the checking and verification of earnings received or due.

In many bank statements important items consist of accrued interest on investments and loans, considered as assets, and of accrued interest on deposits considered as liability. A large number of banks, both state and national, ignore these figures in their statements on the ground that the labor of keeping the amount calculated up to date is greater than the advantage to be obtained in setting them out in the statement. The treasurer of an active young trust company said the other day:

I believe that the system of accruing interest would be an important help to the examiner in making a quick verification of earnings as a whole. It is a simple matter to at least approximate the proper amount of earnings accruing, say each month. On the other hand, should this system not be used, an examiner cannot even approximate earnings, but must performe check the entire sources of earnings in detail, which very few of them would have time to do.

The verification of the various income accounts to ascertain that all of the income from the assets of the bank, and from its services rendered in various forms, have been properly accounted for should surely be undertaken by some one. That some test at least along these lines should be made by the official examiner, there seems to be no doubt. One bank cashier expresses this thought as follows:

As to the income, very serious leakages sometimes occur if the items of interest, discount, etc., are not properly double checked, and a sort of verification of the work done in this department should be required in every thorough bank examination.

Another bank official, urging that the income be checked, says: "It is doubtful if the safe deposit departments of most institutions are ever subject by state authorities to verification with general books."

#### *Examinations by Certified Public Accountants*

It has been shown that with few exceptions, most state banks, trust companies, saving banks and national banks are examined at least once a year. In many states two examinations are required, in some states the number of official examinations is even larger. The

national bank examiners make, as a rule, about two examinations each year. It has also been shown, I think, that the bank examiners, and bank men realize that while some improvements can be made, even under existing conditions, the scope of the official general examination is more or less limited.

In my opinion, the best results could be obtained from official examinations if all the examiners were placed upon a salary and expense basis and a plan worked out by which frequent visits could be made to the banks during the year, at which time some one or more departments of the bank could be thoroughly examined, to the end that during each year the entire ground will have been covered more thoroughly than is possible under the present arrangement. To bring about this change in the methods, a change in the national bank law and in those of many states would first be necessary. In the meantime, and until some such plan is put into effect, I think that the banks generally ought to exercise more general supervision over their own institutions, and employ certified public accountants as far as needed to make the supervision effective.

One form of self-examination has been adopted by several of the clearing house associations in the large cities. Under this arrangement a special examiner is appointed to examine thoroughly the banks in the association. The examiner receives a fixed salary and his assistants are paid directly by the association, so that he has no handicap in the matter of compensation and is free to spend as much time in each bank as he desires, the only limitation being that he must examine each bank once during each year. His reports are made in duplicate, one going to the bank examined, and the other being filed by him in the clearing house vault. The copy of his report on file is not accessible to any person whatever, except the clearing house committee and then only in such cases as he deems are of enough importance to call to the committee's attention.

The present examiner for the Philadelphia Clearing House, was, until recently, a national bank examiner of high character and enviable reputation. He finds time now to go into many details of importance that were obliged to be omitted in the official examinations. More than one matter of consequence has been discovered by him in his capacity as special examiner that could not reasonably be expected to be unearthed by the regular examiner for the government. In speaking of his examinations one of the cashiers said:

The most complete and effective examinations ever made of this bank were inaugurated by Mr. W. M. Hardt, the examiner for the Philadelphia Clearing House Association, who with his assistants (five competent ex-bank clerks) will take charge of any bank in the association about the closing hour, three o'clock P. M., make the settlements complete of both tellers' desks, seal the vaults with all bills receivable and securities; and the next day prove by going over all bills separately, and taking each of the collateral loans for separate examination and market value of said collateral; putting his assistants on the individual ledgers, sending for pass books and proving at least fifty per cent of all accounts and likewise of the general ledger accounts, with all correspondents; including the postings of said ledger for numerous back dates or taking all postings for the pending month. *In fact, to supervise the running of the bank for at least eight or ten days.*

Banks are now having enough official general examinations of the kind possible to be made under existing laws. While some examiners are fully, conscientiously and ably performing their duties there are others whose performance is too clerical in character. Taking the best work of the best examiner as a standard, there is yet room for useful service by certified public accountants in the supervision of the operation of many banks. No arbitrary plan for the examination of all banks can be prepared. The services of outside experts should in each case be arranged to fit the particular requirements of each bank, taking into account the amount and quality of the supervision made by the bank itself.

The frequent visits that can be planned with the opportunity of close study of the bookkeeping transactions and the verification of many things not easily overhauled by the official examiner under present conditions, would be of benefit to all banks excepting, perhaps, those banks which are conducting thorough self-examinations. The visit to a bank at least once each month by a trained expert whose mind is set upon the performance of his duties in such a manner as to be most helpful to the clerks, officers and directors, can scarcely fail to be of benefit to the bank.